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TO : DEPARTMENT OF STATE

INFO : PARIS

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6/1/67

FROM : AMEMBASSY, ROME

DATE: May 24, 1967

SUBJECT : CIVAIR: Fourth Session of US-Italy Negotiations in Rome, May 17, 11:30 AM

REF : Rome's A-1064

Attached as Enclosure 1 to this airgram is the Embassy's informal record of the fourth session of the resumed US-Italy Aviation negotiations in Rome, May 17, 1967.

REINHARDT

MESSAGE CENTER CONTROL
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FORM 4-62 DS-323

Drafted by:	Contents and Classification Approved by:
ECON:PCNarten/ad 5/19/67	USDEL:FELoy

Clearances:

ECON:FBWigginsJr

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From: Rome
Enclosure 1
A-1082

FOURTH SESSION, May 17, 1967, 11:30 AM

NOTE: Absent from the Italian Delegation: Dr. Serafini
Added to the American Delegation: Walter Burch, CAB

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Ambassador Caponazza: Mr. Assistant Secretary, Gentlemen, I welcome you again in the name of the Italian Delegation with the sincere hope that this further stretch of our work will be profitable for both countries. We should have met last week, but on the advice of Mr. Loy, we decided not to have a meeting. Instead, Mr. Loy and Mr. Minetti have had a few contacts with me. I think we did succeed in creating a better understanding between us and in narrowing our points of divergence. I will now ask Mr. Loy to take the floor and to say whatever it is possible or necessary for him to say.

Mr. Loy: Mr.Ambassador, Gentlemen, we have been engaged during the last several weeks in an effort to find an acceptable route package which would be part of, and, as you have been saying, would be the basis of a mutually acceptable agreement. This effort has been so far totally unsuccessful. It has been unsuccessful, in part, because in our view the proposals and the demands made by the Italian Delegation have been totally unrealistic and impossible for us to meet. On the other hand, in your view the propositions we have made and explored have been in your eyes insufficient and ungenerous.

During these talks in Rome, and the previous ones in Washington, and indeed in the conversation between your Prime Minister and the Vice President of the United States, you have repeatedly asked that our problems be considered from a political as well as an economic-commercial point of view. As you undoubtedly know, in a conversation held last Monday between Secretary of State Rusk and Ambassador Fenoaltea, the Secretary of State made clear - and we trust that he made it quite clear - that the problems we have been discussing have been considered in the US at the highest levels of our Government, and that on our side we are aware not only of the economic-commercial consequences but also of the political consequences of having or not having an agreement.

This delegation now proposes to give you a new proposal for a route exchange which is the result of our continued review of our Government's position at the highest level. We hope that with this proposition, we can close out the route part of our discussions and move on to the other questions involved.

We spent some time last week analyzing the demands and requirements of the Italian delegation insofar as we have been able to ascertain them. We have tried to get a feel of what is fundamental and what is less fundamental in these demands. The purpose of our analysis was to try to frame a proposal that would be as close as we could get to meeting the fundamental Italian demands. Very soon after beginning our analysis, we ran into serious difficulties. The first was that in terms of value, that is, the opportunity

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to earn revenues, the Italian demands were such that anyway you turned them they were so excessive as compared to those of the United States that we could not see a way to a solution. The second problem we ran into was that the fundamental Italian request seemed quite clearly to be a route which would put Italy - as it was phrased - in the ranks of the leading airlines around the world, and to Italy this meant a route around the world via the US.

I cannot over-emphasize how difficult we found this problem to be. It involves putting Italy, that essentially contributes no passengers at all into the market between the US and Japan, into the competition on the US-Japan route. It seemed to us that when we combined that essential difficulty with the value difficulty that it would be impossible, or nearly impossible by our standards, to grant this fundamental Italian requirement.

Our review convinced us - and our Secretary of State reiterated this - that we are engaged essentially in an economic-commercial conversation, and in that conversation both sides want essentially the same thing: the most advantageous arrangement possible for its own airlines consistent with the public interest. The US Government holds firmly to the position that that is the kind of conversation we are engaged in here.

Nevertheless, in an effort to go the last mile, to the limit of our abilities, to meet Italian demands and to demonstrate our willingness - and indeed our goodwill - to make an agreement both of us can live with honorably, we are prepared to propose today a route package that will contain for Italy a route around the world via the West Coast of the US in line with the requests contained in that part of the Italian demands.

I don't think I need to stress that for us this is a matter of the most serious domestic concern; that it is something we decidedly do not want to do. It is a proposition that we resisted hard, and I think rightly so, for many years. It is the most revolutionary kind of proposal we could put on the table. I stress this to underline the difficulty we had in making the proposal.

Let me be somewhat more precise about our proposal: We are proposing for the Italian side:

1) a route from Italy via Portugal and the UK to New York;

2) a route from Italy to Boston-Chicago;

3) a route from Italy via Montreal to Los Angeles and beyond Los Angeles to Japan and beyond Japan to Hong Kong and points in Thailand, India, Pakistan, Iran, and back to Italy.

I would like to say a few words about these routes. First, we have tried

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generally to respond in routes one and two to the structure and demands you have suggested. Specifically we have linked Boston and Chicago because that is what you asked for and because we understand that if you use Montreal on a route to the West Coast you cannot use it any longer for Chicago. We have not included all the intermediates you suggested. At one time, in discussing your routes, you spoke of France as a possible intermediate to the US and we would be prepared to add it to route one or two if that is your desire. With respect to the route around the world, we have set it up in a manner you indicated it would be operated: a route around the world from the West Coast of the US to Japan and using points now served beyond Japan to Italy. I have named today only those points West of Japan that you now serve. We would, of course, be prepared to add points West of Japan that a carrier would need, operating that far from home, in order to make the route viable for a long term airline operation.

I want to stress that the package we are proposing has a value in revenue earning capability of over $70 million, and there is no way we can structure our routes that would permit us to match that. I underline that because it indicates the limits to which we have gone and beyond which we cannot go further in meeting your demands.

I would like to say a few words about how we see, and how airline people generally see, the munificence of the round-the-world route we have put on the table. It does two things in the broadest sense: first it puts Italy in a very, very exclusive and elite club of airlines with round-the-world route rights. There are today maybe five that operate around the world in one fashion or another. Of these, only three (a Japanese, an American and a British airline) operate on the most lucrative stretch of the route from the West Coast of the US to Japan.

The second thing the offer does is to place the Italian carrier in the second largest international market - second only to the North Atlantic - the fastest growing international market, and the major market with the highest yields. It is a route with the fantastic revenues. Because of its long-haul nature, it is a most profitable market to operate in, and it is one which has historically operated at high load factors and with high profits. It is, after the North Atlantic, the premier market, and in comparative terms it is even better because it is growing faster and it is less developed. In the US today we have a certification proceeding in which virtually every major American airline is fighting for a chance to participate in this market because of its commercial significance.

And I stress that we are placing this market on a platter for the Italian carrier in full recognition of the fact that Italy contributes virtually no passengers to the market at all - and Italy would be the first country in the world with no territorial claims on one side of the Pacific or the other to operate between the West Coast of the US and Japan.

Let me add a couple of words about the conditions under which we make this proposal, because at this point in the proceedings I don't want any misunderstandings. We would expect the US route schedule to be essential as that described in our Document No. 4 with the following exceptions.

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We would add the UK as an intermediate point and we would propose to add several points in Italy to that part of document No. 4 described as part A, so that part A would read "Milan-Pisa-Turin-Rome-Naples". Route B would remain unchanged. Second: We have said from the very beginning that we could only make an agreement on the basis of full observance of the basic principles that have prevailed so far, I might add that have prevailed to the full benefit of the Italian carrier and the public.

We would not consider this proposal for one instant except with the full application in clear terms of the Bermuda principles applied to all traffic, both passengers and cargo, nor would we consider the proposal except in terms of the full application of the principles of multiple designation of carriers. In stating this I only reiterate what our Secretary of State said to Ambassador Fenoaltea last Monday. In conclusion, let me just say two more thoughts. It is today the 17th of May. I understand that in some parts of Italy that is considered a day of bad luck but let us have our own rules about bad luck. We have little time to conclude an agreement before May 31, as we must try to do if we are to be responsible negotiators. I would hope we could, on the basis of this proposal, conclude our discussion of routes and move on to the rest of the agreement.

My second and concluding thought is this: I am quite fully aware, and our Government is aware, that our proposal excludes certain requests you have made, and on our side it includes certain requests you have resisted. We have made this proposition after full examination of what we could and could not do, and as I said, we are obligated to ourselves, to our industries, to our Government, to stick as closely as we can to the underlying assumption that we are making a commercial-economic agreement under which our carriers will have equal opportunity to make money. When we evaluate what we propose for you and what we propose for us there is a gap in your favor, and a rather substantial one. That puts a rather difficult strain on us.

My feeling is that the US Government has gone pretty far out on a limb. You urged us to look at the political consequences, and we have. But political consequences go both ways. Our proposal creates political problems for us that are probably more serious than those it solves. At the moment we are seeking a successful conclusion of the Kennedy Round of trade negotiations. The American business community is carefully watching the US Government at a time when we are under some criticism for pushing East-West trade. There are strong elements in the US that will question - and rightly so - any commercial arrangements the US Government makes, and will be critical of any arrangements which, presumably for the sake of international political friendship, are bad deals with the US.

We expose the US Government to that sort of criticism in the offer we make today. We do so after careful calculation of the risks we can take. To do so we believe

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we must go to the very limit with you in an effort to make an agreement. We believe we have done so. We expect that the Italian Delegation will similarly examine our proposal and we expect that on that basis we can reach an agreement. I think that is all, Mr. Ambassador.

Ambassador Capomazza: Mr. Assistant Secretary, Gentlemen, I suppose that you do not expect that I should give an answer to your proposal at this time. We do admit and recognize that we are moving away from the rigid point in which we have been for the last few months - but we do still see ourselves far from the point at which we could consider ourselves to be reaching an agreement.

I want to give the proposal all the careful consideration it deserves. We have taken note of what the Secretary of State told Ambassador Fencaltea, and we do share the hope that we will be able to reach an agreement. I may say that we must consider not only an exchange of values, but also the fact that here two friendly countries are trying to take into consideration certain political aspects as well.

I don't know whether you would be willing to give us some clarifications right now, or whether you would prefer us to have our conversation between ourselves and meet later. It might be to the point if I said a few words about the discussions Mr. Minetti and you and I have had during the past few days. We oppose the grant of any route to Australia and South Africa to your carriers - I might say that that is almost a sine qua non for us. In spite of this, you have referred to your document No. 4 and it contains these two routes. I think it is essential that there be no misunderstanding that we cannot give these two routes. If you could clarify this it would make it easier for us.

Second, I do note that in the way you structure your last offer, your proposition, you have cut out points in the US that have been mentioned before in connection with our long-standing aspiration to fly to Mexico and South America through your country. If you think this is the proper moment to make some explanation on these points, all right, or if you would rather wait until we meet among ourselves, that is your choice. I would like also to say that at a certain moment we would like to look at your route schedule, not only from the negative point of view regarding Africa and Australia, but also from the positive point of view on the points you will serve. We will not be rigid in this, but our ability to reach an agreement will depend on some of the points being claimed.

Mr. Loy: I can say a few words about the principle issues you have raised right now. In respect to the routes to Australia and Africa, we have not misunderstood your position and your desires in this at all, nor have we misunderstood your reluctance - your strongest reluctance - to include those in the package. We have been strongly reluctant ourselves to granting Italy a route around the world through the US, so I recognize the fact that is difficult. We have undertaken something which, especially with respect to dollar values, is far more difficult. So those routes are in the package quite consciously.

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With respect to your second point, again, we are quite aware that we have excluded from what we propose, some points in the US and the route to Mexico. But I would like to submit that the name of this game is not "how many pieces of candy can we give to the youngster who is crying for as many as he can get". The game we are playing is how to make a commercial agreement that is as equal as we can get it. There is no way that we can add another route to the US or Latin America and stay within the range of equal opportunity to earn money. I think that is all I can say.

Ambassador Capomazza: I did not quite understand what you said about Australia and Africa. You know, you sometimes do speak a little cryptically, or perhaps it is because my English is less refined than it ought to be. I wonder if you could make that clearer.

Mr. Loy: We read very clearly that you do not want to grant us routes beyond to Australia and Africa. Nevertheless, those routes are in the package. We first of all don't think that will hurt you very much, but if it hurts, we are also hurting ourselves in what we propose. We have broken through one of our impossibilities in what I must call a climactic fashion. And furthermore, without these routes included, the value gap gets even wider. So I don't see how we can take them out.

Ambassador Capomazza: You see that in the case of these routes, you yourself value them so low in your calculations, that that in itself implies, or in fact confirms clearly, that introducing the US carriers with their Bermuda principles on those routes would profit you very little but would throw our operations completely out of kilter. Therefore, while we take a drop of water out of the enormous Pacific ocean, you with these two routes could completely disrupt the services of Alitalia. I wanted that point clearly brought home.

I would also like to say that our time is short, and I hope that our review of our proposal could be more concrete. If I could start from the point that these two routes were out, it could save three or four days' time. We see clearly that some amount of time will be necessary. There is no hurry on our part, but we share your responsible desire that both parts reach an agreement in due course, and before the deadline.

Mr. Loy: First, with respect to values, we have put values on what we have granted you, and we have also put values on the East and South African and Australian routes. I don't think our use of these routes would hurt you, based on our estimates of what are realistic fair assumptions as to US carrier operations and carriage of traffic to those areas. We haven't valued them all that low, considering the fact that in the case of East Africa in particular we have at the moment two different routes there, one of which has nothing to do with Rome. Considering our difficulties in making arrangements concerning East Africa, and considering the small size of the market, we have perhaps valued them higher than we should.

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With respect to Australia we know what the service is now. The UK for example, operates through Rome to Australia, so we can make reasonable estimates of the market and it does not come to all that much. It might be disruptive or uncomfortable for the pool operators, but that's life. You say, take it out. I say, why? Because you say it is uncomfortable? That is not a good enough reason. We are uncomfortable at this very minute. So I am afraid that if our insistence on these routes costs us an agreement, that is too bad. But just because you would rather we did not fly them, is not a good enough reason for us to have their absence further increase the imbalance in values in the agreement. So we can't take those routes out.

Ambassador Capomazza: You twice mentioned some points that I don't see in the offer now. Can you say something about those points?

Mr. Loy: If the Italian delegation would prefer to forego the route across the Pacific and on around the world, and would like to put together a different package, we are prepared to consider that.

Ambassador Capomazza: I don't know if you really understood how important are the parts of the proposal put forth by the Assistant Secretary that he called "conditions". These conditions cannot perhaps all be measured with the yardstick of dollar value, but they are for us nevertheless very important. We are told that this deal implies Bermuda principles for passengers and cargo, and implies multiple designations. Without by any means wanting to enter into a philosophical discussion, let me say that we have already touched in the past on some occasions the Italian position on capacity. Shall I remind the honorable gentlemen that rightly or wrongly our policy has been upheld for the last ten years, and this policy has withstood the pressure of our desires for increases in routes, to the point where we have finally been brought to denunciation. This has been the Italian policy for the last ten years. When you came you said you were not coming to change the policy of the US. What if I said the same thing about my policy; that I did not take this job to change the long-term policy of the Italian Government. Let us see then where we would stand. I would say we would stand at the point where we first met. I would not consider valueless this request for Bermuda capacity and multiple designation, as though it were something to be granted en passant. I will not say more, in order to keep our conversations on a friendly basis and to avoid confusion. This is confusing, and it can lead to problems unless there is a more open-minded consideration of our point of view on the part of the US delegation.

I suggest we adjourn. If it is all right with you we can meet here tomorrow at 5 P.M.

Mr. Loy: Agreed.

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